

Central Intelligence Agency



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DIRECTORATE OF INTELLIGENCE

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CHINA'S PROGRAM TO UPGRADE INDUSTRY [REDACTED]

Summary

A cornerstone of Beijing's industrial modernization plan during the 1980s and 1990s is a program to use foreign technology and equipment to upgrade many of China's 400,000 factories. This multibillion dollar effort initially will give priority to textile and other light industries and to machine building and electronics. Japanese firms have so far been predominant in conducting feasibility studies at plant sites, although the Chinese are attempting to encourage companies from other countries to become more active. Commercial opportunities clearly exist for US firms if they aggressively push to participate. [REDACTED]

The Chinese have had some success in their early effort to upgrade industrial sectors, but overall progress generally has been slower than Beijing anticipated. Many of the plants surveyed for possible upgrading are too old and dilapidated to house modern production lines. [REDACTED]

[REDACTED] We expect these and other problems to force the Chinese to push back their timetable for 1983; they had hoped to start work this year on modernizing up to 3,000 plants. The program testifies to China's willingness to rely more than at any time in the past on the West for assistance in industrial modernization. We believe, however, that greater progress than has occurred to date will be necessary during the next couple of years if the upgrade program is to succeed over the long term. [REDACTED]

This memorandum was produced by [REDACTED] the China Division of the Office of East Asian Analysis. Questions and comments are welcome and may be addressed to the author [REDACTED]

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Why Upgrade Industry

A variety of reasons motivated the Chinese to start renovating their aging industrial base. The leadership concluded that upgrading existing plants is cheaper and faster than building new facilities from the ground up. This program has been under debate for several years between economists who wanted "intensive" development (upgrading) and those who wanted "extensive" development (new plants). The issue was apparently put on firmer ground at the National People's Congress last December when Premier Zhao Ziyang supported upgrading in his speech on the Sixth Five-Year Plan (1981-85). Since that time, the debate has simmered down, and current plans are to push ahead with a goal of starting work on 3,000 renovation projects this year. [REDACTED]

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Primary objectives of upgrading old plants are to reduce consumption of energy and raw materials, increase the variety of goods, produce new items for export, and substitute quality domestic goods for imports. Among these, the energy issue is repeatedly raised by the Chinese. The leadership continually complains that China consumes as much energy as Japan but that total industrial and agricultural output is only one-fourth as high. Replacing obsolete machinery with more energy-efficient equipment thus is one of the basic motivations for the program. [REDACTED]

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Another extremely important goal is to improve the overall quality of industrial production. The quality of many of China's products is so low that they cannot be sold on either the international or domestic market and must be stockpiled at great expense. For example, although China has a shortage of high quality steel and must rely on imports, 20 million tons of low grade rolled steel is presently in storage. The Chinese also have huge amounts of poor quality household appliances in state warehouses, including \$320 million worth of washing machines and black and white television sets. Upgrading existing plants, therefore, is aimed at producing higher quality products that can readily be exported or sold domestically. [REDACTED]

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Financing the Program

Premier Zhao announced at the last National Peoples Congress that China plans to invest the equivalent of \$65 billion (130 billion yuan) during the Sixth Five-Year Plan (1981-86) to upgrade enterprises.* This total is almost 50 percent higher than the amount allocated to the critical bottleneck sectors of energy and transportation. Approximately \$24 billion was invested in 1981-82 and \$12 billion is planned for this year.

* Converted at a rate of two yuan to one US\$.

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The modernization effort is intended to pick up momentum as the plan moves along, with \$30 billion to be spent in 1984-85. []

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Funds to upgrade plants will be partly supplied out of government revenues (10 percent) and domestic bank loans (30 percent). The remaining 60 percent of the funds will come from enterprise depreciation reserves, local governments, and foreign investors. The Bank of China plans to loan \$1 billion to 1,000 enterprises with export potential during the next three years from foreign exchange presently on hand. []

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Beijing clearly intends to rely heavily on foreign sources of capital to help pay for plant renovation. The Chinese hope to obtain government-to-government loans from Japan and other countries and additional financing from private banks. International organizations also are expected to chip in a share of the total cost. The World Bank, for example, has already agreed to lend China \$70 million to be used over the next several years to renovate medium- and small-size factories. []

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Priority Industries

The sectors chosen for priority attention during the initial stages of the upgrade program are textiles and other light industries and the machine building and electronics industries. These industries have received top priority because they are among China's oldest and their technological level is among the lowest. Chinese spokesmen claim that the bulk of the equipment in the textile and other light industries is at a level of the 1940s and 1950s and that more than 20 percent should be replaced immediately. In addition, the textile industry is China's primary earner of hard currency, and the PRC plans to boost exports sharply in coming years to acquire the foreign exchange needed to finance its modernization effort. []

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Machine building and electronics industries are also high on the list for renovation because they provide the basic inputs for developing all other industrial sectors. China's machine building industry was established largely with Soviet assistance and the technological level of the output at most factories is far below international standards. Chinese officials maintain that 60 percent of machine building production is at the technology level of the 1940s and 1950s. Another 30 percent is at the level of the 1960s and only 5 percent has reached the level of the 1970s. Upgrading the technical level of machine building and electronics plants is a critical first step in reducing Chinese dependence on foreign sources for the sophisticated equipment that is needed to modernize both civilian and defense industries. []

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Administering the Program

The program to renovate existing plants is being administered under the jurisdiction of both central and local

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authorities. The vast majority of plants to be upgraded, however, will be under the control of individual provinces and municipalities which are authorized to operate directly with foreign firms. Control over a particular project depends largely on its cost. [REDACTED]

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Favored Locations for Ugrading

Officials of the State Economic Commission have stated that the upgrade program will initially be concentrated in the older industrial centers located along the sea coast. All of the model plants chosen by the SEC to be renovated are located in Shanghai, Beijing, Tianjin, and in Liaoning, Jiangsu, or Shandong Provinces. [REDACTED]

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Shanghai's industrial base is in particular need of renovation because the city is starting to lose its preeminent position as a supplier of industrial goods and as a source of revenue to the state. In recent months, Shanghai officials have announced ambitious plans to reverse the industrial decline and renovate many of the city's 8,000 enterprises. Efforts will be focused in improving enterprises that produce textiles, machinery, electronics, and building materials. To help spur the upgrade program, Shanghai sponsored an investment conference late last year that drew 150 foreign firms. Shanghai officials want initially to upgrade 60 enterprises with foreign assistance and ultimately as many as 700. [REDACTED]

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The Role of Japan

Japan has been the primary country to participate in China's industrial renovation program. [REDACTED]

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Japanese firms have concluded a number of feasibility studies during the past year at individual plant sites and have agreed to additional studies in 1983. [REDACTED]

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[redacted]

[redacted] A major problem is that in addition to trying to integrate old and new equipment, China will also need to import expensive technical know-how and retrain thousands of employees to operate and maintain sophisticated machinery. Moreover, many of the plants [redacted] were built in the 1950s or earlier and are too old and dilapidated to house modern production lines. [redacted]

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China's upgrade program also has run into difficulties because of financial squabbles over who should pay for what.

[redacted] PRC officials refuse to pay fees to companies that have sent technicians to examine plants. The Chinese argue that they are justified in not paying because Japanese firms are asking unfair prices to renovate plants and that survey fees should be absorbed by the companies. Chinese negotiators have so far refused to change their position and have threatened to look elsewhere for assistance. [redacted]

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Until recently, reports in the Chinese press characterized the technical renovation program in glowing terms. A month ago however, the Chinese started to qualify their assessment. A People's Daily article in January stated that the upgrade program has developed "relatively slowly" and a "breakthrough has yet to occur."

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The US and Other Countries

European and American companies have shown some interest in participating in China's industrial renovation program but on a much smaller scale than the Japanese. A feasibility study group from the EEC visited China last January, and the State Economic Commission recently sent a delegation to Brussels to discuss the renovation program with European officials. Several US firms have conducted surveys in China, particularly in the minerals and metals industries. Overall, however, the Chinese are disappointed that US companies have not been more interested. An additional problem, according to a high official of the SEC, is that the US export licensing system creates a disincentive for China in purchasing high technology items from the United States. He added that European and Japanese companies were often able to offer the same technology with no mention of licensing requirements. [redacted]

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Outlook

The industrial upgrade program has the potential to involve foreign firms on a much larger scale in China's modernization efforts than all other foreign-assisted projects currently underway. It testifies to China's growing willingness to rely on the West for assistance in industrial modernization, and at the same time is viewed by Beijing as a test of the West's ability

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and desire to assist China. In many ways, the program recalls the massive efforts of the USSR in helping to establish China's industrial base during the 1950s. [REDACTED]

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Greater progress than has occurred to date will be necessary during the next year or two, however, if the upgrade program is to succeed. Persistent problems in implementation and a lack of interest by foreign firms could in time reignite the domestic debate over the most appropriate route to achieve industrial modernization. The next two years will be crucial. [REDACTED]

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